

**REPORT OF EXAMINATION**  
**Fraternal Beneficial Association**  
**As of December 31, 1995**



**Fraternal Beneficial Association**

**CHIEF EXAMINER'S AFFIDAVIT**

I certify that I have reviewed the Report of the Financial Examination of Fraternal Beneficial Association of Spokane, Washington, as of December 31, 1995.

\_\_\_\_\_  
JACQUELINE L. GARDNER, CFE, FLMI  
Chief Examiner

4/11/97

## **Fraternal Beneficial Association**

### **TABLE OF CONTENTS**

	<b><u>Page</u></b>
Table of Contents	1
Transmittal to Commissioner	2
Scope of Examination	2
Instructions	3
Comments and Recommendations	3
History	4
Management and Control	4
Corporate Records	5
Conflict of Interest	5
Internal Security	5
Employee Welfare and Pension Plans	6
Territory and Plan of Operation	6
Growth of Association	6
Loss Experience	7
Market Conduct	7
Accounts and Records	7
Subsequent Events	7
Financial Statements	
Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 1995	8
Underwriting and Investment Exhibit for the year ended December 31, 1995	9
Comparative Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 1995 and 1994	10
Comparative Underwriting and Investment Exhibit for the year ended December 31, 1995 and 1994	11
Notes to the Financial Statements	12
Acknowledgment	14
Affidavit	15

## **Fraternal Beneficial Association**

February 18, 1997

Honorable Deborah Senn, Commissioner  
Washington Department of Insurance  
Insurance Building  
P.O. Box 40255  
Olympia, Washington 98504-0255

Dear Commissioner:

Pursuant to your instructions and in compliance with the requirements of the state of Washington, an examination has been made of the corporate affairs and financial records of:

Fraternal Beneficial Association  
of  
Spokane, Washington

hereafter referred to as the "Association" or "FBA" at its home office located at 12414 E. 26th Ave., Spokane, WA 99216. The following report is respectfully submitted.

### **SCOPE OF EXAMINATION**

Our examination included a review of the business affairs and financial condition of the Association for the period ended December 31, 1995. The examination was performed in accordance with procedures promulgated by the National Association of Insurance Commissioners (NAIC) and in compliance with the provisions of Washington State insurance laws and regulations.

## **Fraternal Beneficial Association**

### **INSTRUCTIONS**

No instructions were issued as a result of this examination.

### **COMMENTS AND RECOMMENDATIONS**

#### **1. Claim Files**

During the review of paid claims, it was noted that the claim files had sparse documentation on the verification and detail of the losses paid. In some instances, the files contained a one page summary by Association Appraisers that were not complete or filled out in its entirety. In addition, two claims were found to be appraised by relatives of the claimants. It is recommended the Association implement strict guidelines for claim documentation that clearly and conclusively establish the loss. Additionally, all Association Appraisers should be required to get independent loss appraisals for relatives in their district to dispel any appearance of a conflict of interest.

#### **2. Annual Audits**

The Association does not have annual independent certified audits nor do they feel it would be economically feasible. Therefore, it is recommended that the Executive Committee establish an audit committee to review Association accounts and records at least annually.

#### **3. Administrative Contracts**

The Association's Secretary/Treasurer, Linda Cupp, has been independently contracted by the Association to maintain all of the accounting and reporting functions for FBA. Linda Cupp is the sole proprietor of L.C. Accounting Services which has been retained by the Association for the accounting and reporting services. The Executive Committee approved the use of L.C. Accounting Services but no written contract was ever consummated. It is recommended the Association enter into a formal written contract with L.C. Accounting Services that details the services rendered and the reimbursement methodology for those services.

## **Fraternal Beneficial Association**

### **HISTORY**

The Association was originally organized under the name of Unterstutzungs Verein von Spokane and Whitman Counties (literally translated: German Mutual Assistance Association of Spokane and Whitman Counties) in 1891 as a fraternal mutual property insurer organization. The name was changed in 1918 to Fraternal Beneficial Association of Eastern Washington and Idaho. The original certificate of authority was issued by the Washington State Insurance Commissioner in 1918 to transact the business of insurance as a fraternal mutual property insurer. To date, the Association only offers fire protection property coverage. The Company primarily sells to farmers in Eastern Washington.

### **MANAGEMENT AND CONTROL**

The constitution and bylaws of the Association vest the management and control of the affairs of the Association in an Executive Committee consisting of a president, first vice president, second vice president, secretary-treasurer and assistant secretary-treasurer. In addition, the governing documents require the president to appoint two members who with the five elected officers shall constitute an executive committee. All officers must be members of the Association and are elected annually at the June meeting by ballot of the members.

#### **Officers and Appointees as of December 31, 1995:**

<u>Name</u>	<u>Position</u>
Lawrence D. Baumgartner	President
John Druffel	First Vice President
Sharon McCoy	Second Vice President
Linda Cupp	Secretary-Treasurer
Joe Schmitz	Asst. Secretary-Treasurer
Ervin Leitz	Appointee
David Buob	Appointee

#### **Concentration of ownership:**

There are approximately 590 shareholders. To become a shareholder, members must have applied and been accepted as a policyholder. Prospective members must be farmers and have the potential of producing five hundred dollars or more of agricultural crops that could be sold. Shares are not actively traded and each stockholder has an ownership interest in an amount equal to the face value of his/her policy.

## **Fraternal Beneficial Association**

### **CORPORATE RECORDS**

Review of the minutes of the Executive Committee, Annual Shareholders and Appraiser's meetings were conducted for the five years under examination. No changes were made to the corporate bylaws and constitution. The executive committee discussed the possibility of increasing the maximum policy limit of \$150,000 to \$200,000. The Association's ability to raise policy limits is governed by RCW 48.11.140 which states, "No insurance shall retain any risk on any one subject of insurance, whether located or to be performed in this state or elsewhere, in an amount exceeding 10 percent of its surplus to policyholders." The Executive Committee expressed its desire to increase the assets of the Association in order to increase their policy limits.

### **CONFLICT OF INTEREST**

The Association policy concerning conflict of interest was found to be appropriate. No conflicts were disclosed for the period of our examination.

### **INTERNAL SECURITY**

#### **Fidelity Insurance:**

The Association is the named insured on a fidelity bond issued by the Reliance Insurance Company. The coverage is a \$100,000 dollar fidelity bond on the officers of the Association. This exceeds the minimum suggested by the National Association of Insurance Commissioners of \$25,000 for a company of this size.

#### **Internal Controls:**

The Association contracts all of its accounting and policy service functions to an accounting service (the Service) which is owned and operated by Linda Cupp, the Association's Secretary/Treasurer. The Service supplied documentation on the controls in place for receipts, disbursements and investments. The controls were reviewed for appropriateness and adequacy. The review determined that the controls were minimal due to lack of division of duties. Linda Cupp essentially runs the entire operation. Due to this controlled environment, minimal reliance was placed on the controls and the Association agreed to have an annual review of the accounts and records by the President to add an additional check and balance to the operations.

## **Fraternal Beneficial Association**

### **EMPLOYEE WELFARE AND PENSION PLANS**

The Association does not have any paid employees and therefore does not offer a pension plan or any other employee welfare plans.

### **TERRITORY AND PLAN OF OPERATIONS**

The Association is organized and authorized to transact the business of property insurance in the state of Washington. The Association's business is conducted under an assessment premium plan. The principal place of business is in Spokane, Washington. The Association provides fire and smoke damage insurance to its members who are primarily farmers of eastern Washington and northern Idaho.

The territory covered by the Association is divided into districts, each district having an appraiser appointed by the President. The duties of the appraisers, as defined by the Association's Constitution and Bylaws are: to receive applications for membership; to inspect all properties offered for an appraisal; to examine carefully all fire hazards, and either approve or reject applicants for membership; to reinspect insured property at least every ten years; to submit reports of all fire losses to the secretary/treasurer; to make a complete report of findings if arson is suspected; to reappraise property if so requested by members; and to take into account storage facilities of gasoline as to whether or not they constitute fire hazards.

### **GROWTH OF THE ASSOCIATION**

The growth of the Association is reflected in the following exhibit compiled from the Association's Annual Statements as of December 31:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
1991	\$1,180,721	\$ -0-	\$1,180,721
1992	1,254,105	-0-	1,254,105
1993	1,342,853	-0-	1,342,853
1994	1,446,452	-0-	1,446,452
1995	1,558,731	-0-	1,558,731

## **Fraternal Beneficial Association**

### **LOSS EXPERIENCE**

The following exhibit reflects the underwriting operations of the Association by year, beginning in 1991. The amounts shown were compiled from copies of the Association's annual statements:

<u>Year</u>	<u>Net Premiums Earned</u>	<u>Losses Incurred</u>	<u>Underwriting loss Ratio</u>
1991(*)	\$36,545	\$102,513	(281)%
1992	73,184	55,894	76
1993	70,623	7,809	11
1994	71,889	2,144	3
1995	\$71,632	\$ 23,583	33%

(\*) = For the Association's hundred year anniversary premiums were reduced by one half for 1991 only.

### **MARKET CONDUCT**

As part of the financial examination, a limited market conduct review was performed on complaints, advertising, claims and agent licensing. The Association did not have any complaints, advertising or agents for the five years under examination. A subjective sample of claims was reviewed from the period 1992 through 1995. Two recommendations were made regarding Claim file documentation and related appraisers and claimants. See Comments and Recommendations section of report.

### **ACCOUNTS AND RECORDS**

The Association's accounts and records are maintained on a Generally Accepted Accounting Practices (GAAP) Basis of accounting and are converted to Statutory Accounting Practices (SAP) accrual basis for reporting purposes.

### **SUBSEQUENT EVENTS**

No significant subsequent events were disclosed during this examination of the Association.

### **FINANCIAL STATEMENTS**

**FRATERNAL BENEFICIAL ASSOCIATION**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**December 31, 1995**

<b>Assets</b>	<b>Balance</b>			<b>Balance</b>
	<b><u>Per Company</u></b>	<b><u>Ref</u></b>	<b><u>Adjustments</u></b>	<b><u>Per Exam</u></b>
Bonds	\$20,000			\$20,000
Cash on hand and on deposit	132,115			132,115
Short term investments	1,371,949			1,371,949
Premiums in course of collections	82			82
Interest income due and accrued	<u>34,585</u>			<u>34,585</u>
<b>Total assets</b>	<b><u>1,558,731</u></b>		<b><u>0</u></b>	<b><u>1,558,731</u></b>
 <b>Liabilities, surplus and other funds</b>				
Gross paid in and contributed surplus	<u>1,558,731</u>			<u>1,558,731</u>
<b>Total liabilities, surplus and other funds</b>	<b><u>\$1,558,731</u></b>		<b><u>\$0</u></b>	<b><u>\$1,558,731</u></b>

**FRATERNAL BENEFICIAL ASSOCIATION**  
**Underwriting and Investment Exhibit**  
**For the Year Ended 1995**

	<u>Balance</u> <u>Per Company</u>	<u>Ref</u>	<u>Adjustments</u>	<u>Balance</u> <u>Per Exam</u>
<b>Underwriting Income</b>				
Premiums earned	\$71,632			\$71,632
Deductions:				
Losses incurred	23,582			23,582
Loss expenses incurred	1,715			1,715
Other underwriting expenses incurred	<u>25,849</u>			<u>25,849</u>
Total underwriting deductions	<u>51,146</u>			<u>51,146</u>
Net underwriting gain or loss	<u>20,486</u>		<u>0</u>	<u>20,486</u>
<b>Investment Income</b>				
Net investment income earned	<u>91,654</u>			<u>91,654</u>
Net investment gain or (loss)	<u>91,654</u>		<u>0</u>	<u>91,654</u>
<b>Other Income</b>				
Finance and service charges not included in income	<u>140</u>			<u>140</u>
Total other income	<u>140</u>		<u>0</u>	<u>140</u>
<b>Net Income</b>	<u><u>112,280</u></u>		<u><u>0</u></u>	<u><u>112,280</u></u>
<b>Capital and surplus, December 31, 1994</b>	<u>1,446,452</u>			<u>1,446,452</u>
Net income	<u>112,280</u>			<u>112,280</u>
<b>Net change in capital and surplus for the year</b>	<u>112,280</u>			<u>112,280</u>
<b>Capital and surplus, December 31, 1995</b>	<u><u>\$1,558,732</u></u>		<u><u>\$0</u></u>	<u><u>\$1,558,732</u></u>

**FRATERNAL BENEFICIAL ASSOCIATION**  
**Comparative Statement of Assets, Liabilities, Surplus and Other Funds**  
**For December 31, 1995 and December 31, 1994**

<b>Assets</b>	<b><u>1995</u></b>	<b><u>1994</u></b>
Bonds	\$20,000	\$20,000
Cash on hand and on deposit	132,115	110,382
Short term investments	1,371,949	1,309,513
Premiums in course of collections	82	44
Interest income due and accrued	<u>34,585</u>	<u>26,513</u>
<b>Total assets</b>	<b><u>1,558,731</u></b>	<b><u>1,466,452</u></b>
 <b>Liabilities, surplus and other funds</b>		
Gross paid in and contributed surplus	<u>1,558,731</u>	<u>1,466,452</u>
<b>Total liabilities, surplus and other funds</b>	<b><u>\$1,558,731</u></b>	<b><u>\$1,466,452</u></b>

# Fraternal Beneficial Association

## FRATERNAL BENEFICIAL ASSOCIATION Comparative Underwriting and Investment exhibit For the Years Ended 1995 and 1994

	1995	December 31: 1994
<b>Underwriting Income</b>		
Premiums earned	\$71,632	\$71,889
Deductions:		
Losses incurred	23,582	2,144
Loss expenses incurred	1,715	2,367
Other underwriting expenses incurred	<u>25,849</u>	<u>24,989</u>
Total underwriting deductions	51,146	29,500
Net underwriting gain or loss	<u>20,486</u>	<u>42,389</u>
<b>Investment Income</b>		
Net investment income earned	<u>91,654</u>	<u>61,050</u>
Net investment gain or (loss)	<u>91,654</u>	<u>61,050</u>
<b>Other Income</b>		
Finance and service charges not included in income	<u>140</u>	<u>160</u>
Total other income	<u>140</u>	<u>160</u>
<b>Net Income</b>	<u><u>112,280</u></u>	<u><u>103,599</u></u>
<b>Capital and surplus, December 31, 1994</b>	<u>1,446,452</u>	<u>1,342,853</u>
Net income	112,280	103,599
<b>Net change in capital and surplus for the year</b>	<u>112,280</u>	<u>103,599</u>
<b>Capital and surplus, December 31, 1995</b>	<u><u>\$1,558,732</u></u>	<u><u>\$1,446,452</u></u>

## **Fraternal Beneficial Association**

### **NOTES TO THE FINANCIAL STATEMENTS**

#### **Accounting Policies**

- A) Basis of presentation  
The financial statements included herein have been prepared in accordance with statutory accounting practices prescribed or permitted by the Washington Insurance Commissioner.
- B) Investments  
Investments are stated on the basis of rules promulgated by the National Association of Insurance Commissioners. Bonds, mortgage loans and short term investments are at amortized value. Preferred and common stocks are valued at market.
- C) Property, Plant and Equipment  
Buildings, land and computer equipment are recorded at cost. Depreciation is computed on a straight line basis over the estimated life depending on the type of asset and statutory regulations.
- D) Underwriting expense  
Underwriting costs such as commissions and general insurance expense are written off in the year incurred and not deferred and amortized against future earnings.
- E) Non-admitted assets  
Certain assets designated as "non-admitted," consisting of certain receivables more than 90 days past due, prepaid expenses, furnishings, equipment and all electronic data processing equipment not meeting the criteria set forth in RCW 48.12.10, have been excluded from the balance sheet. The changes in such assets are reflected as adjustments to net worth.

**Cash and Cash Equivalents** **\$ 132,115**

Cash and cash equivalents as of December 31, 1995 consist of the following:

Bank of Fairfield - Checking Account	\$ 3,974
Washington Mutual Bank - Savings Account	73,082
Washington Trust Bank - Liquid Asset Account	<u>55,059</u>
Total	<u>\$ 132,115</u>

All deposits have ninety days or less maturities.

## Fraternal Beneficial Association

<b>Short Term Investments</b>	<b>\$ 1,371,949</b>
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Approximately 88% of the Association's assets were held in short term investments as of December 31, 1995. These investments consisted primarily of certificates of deposit and money market certificates. All were invested in financial institutions with federal deposit insurance and the Association's policy is to keep all investments in any one bank to one hundred thousand dollars or less. Approximately 98% of short term investments were confirmed for our examination.

<b>Direct Premiums Earned</b>	<b>\$ 71,632</b>
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In 1995, the Association's direct premiums earned, by state, on fire policies written consisted of the following:

Washington	\$ 61,721
Idaho	<u>9,911</u>
Total	\$ <u><u>71,632</u></u>

The Association is not licensed in Idaho but has contacted the Idaho Attorney General's Office and the Idaho Insurance Commissioner's Office in 1967 to determine compliance with Idaho statutes. It was the opinion of both Idaho state offices that the Association's best course of action would be to continue operations as a "family type" organization as they have in the past and in the future if any successors of their offices wished to pursue another determination, the issue would be addressed at that time. Idaho has not changed its determination as of the date of this examination.

## **Fraternal Beneficial Association**

### **ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by Linda Cupp, Secretary/Treasurer of the Association during the course of this examination.

In addition, acknowledgment is made of the participation in the work and preparation to this report by Michael V. Jordan, CPA, CFE, Examiner-in-Charge and Joseph I. Manning, CPA, CFE; from the Washington Insurance Commissioner's Office.

## Fraternel Beneficial Association

## AFFIDAVIT OF EXAMINER IN CHARGE

STATE OF WASHINGTON )  
 ) ss  
COUNTY OF KING )

Michael V. Jordan, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Fraternal Beneficial Association was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Michael V. Jordan, CPA, CFE  
Examiner-in-charge  
State of Washington

Subscribed and sworn to before me this 11th day of April , 1997.

Notary Public in and for the  
State of Washington, residing  
at Seattle.